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October 12, 2010

Honorable Mayor Robert Kiss
and Members of the City Council
City of Burlington
Burlington, Vermont 05401

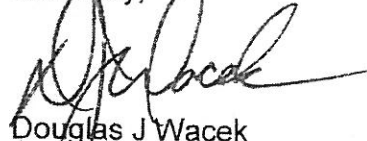
On behalf of the Audit Task Force (ATF) created by Resolution 3.07 of the Burlington City Council, enclosed is our final report containing recommendations concerning the City of Burlington's current audit process and procedures.

Since its formation on September 1, 2010, the ATF met 7 times, reviewed a host of documents related to the City's audit, and met with various officials of the City and its current audit firm. The attached report reflects the unanimous view of all the members of the ATF: Mr. Paul Birnholz, Mr. Edward Gallagher, Ms. Marcia Merrill, Ms. Kimberly Pinkham and Mr. Douglas Wacek.

We wish to extend our appreciation to City officials, especially Scott Schrader, for their cooperation and assistance during the course of our review.

Should you have any questions concerning this report, please don't hesitate to contact me or any other member of the ATF.

Sincerely,



Douglas J Wacek
Chair

Cc: Members - Audit Task Force

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Audit Task Force
Final Report
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BACKGROUND

Pursuant to Resolution 3.07 passed by the Burlington City Council, an Audit Task Force (ATF) comprised of five individuals with professional auditing backgrounds was created to consider and assess the City's audit processes, procedures and to make recommendations to improve the current audit protocols for the City. Members of the ATF, all of whom are Certified Public Accountants, are Paul Birnholz, Edward Gallagher, Marcia Merrill, Kimberly Pinkham and Douglas Wacek, who served as Chair.

This report represents the efforts of the ATF to meet the fundamental objectives of the Resolution and provide recommendations to the Burlington City Council for its consideration. Recommendations included herein are unanimous, unless noted.

MISSION

Since some of the terminology used in the Council's resolution was not entirely consistent with professional standards for Certified Public Accountants and with auditing standards generally, the ATF restated its mission as follows:

The Burlington Audit Task Force has come together at the request of the City of Burlington as a group of local audit professionals for the purpose of reviewing the overall process by which city officials fulfill their fiduciary responsibilities regarding audits of the City's financial operations and to make recommendations to improve the overall audit process.

WORK PLAN

As a means of guiding its efforts and to stay within the boundaries of its Mission, the ATF developed the following Work plan:

I. Audit Scope - Consider the scope of the City audit, relative to all entities that the City controls and/or is responsible for; understand who is being audited separately and why; consider the extent that other entities/enterprises are subject to audit procedures; consider if any recommendations re: scope of audit engagement.

II Engagement Decision Process & Procedures - Consider the overall process and procedures deployed by the City to engage the Auditors; review RFP process, recipients, responders, engagement letters and interview the current audit firm. Consider any recommendations for this process relative to engagement decisions, reviews, approvals and procedures.

III Audit Planning & Field Work - Discuss with City and audit firm personnel; review documentation regarding timelines, reporting responsibilities, etc.; consider extent of non-audit (accounting) services provided versus audit services; consider materiality guidelines and how an overall level of materiality for the City might affect individual audit units; and consider the audit planning and field work process.

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IV Wrap-Up and Reporting - Review the process by which audits are accepted by the City and others; review process of communication of audit results, legal representations, management representation letters, and the management letter(s); consider the impact of the City's organizational structure on this process, particularly Burlington Electric Department (BED), School Department, and other major enterprise funds or business activities; and review follow-up process regarding the management letter and/or audit adjustments and/or other communications from the Auditors.

V Other Related Issues

- Consider Pros and cons of separate audits of school Department
- Consider Pros and cons of separate audits of some or all of enterprise funds (perhaps on a rotational basis)
- Consider audits of pension plans or other major areas of importance to the City; consider agreed upon procedures report vs. financial audit.
- Consider Education on the audit process and appropriate role and follow-up by City officials (review & consider role of Board of Finance (Audit Committee) relative to City Council, the Mayor, CAO and other bodies (School Board) relative to Best Practices, State Statutes and the City's Charter.

In connection with its Work Plan, the ATF met with various individuals, including the Mayor and representatives from the City Council, the Chief Administrative Officer and key members of his staff, the City Attorney, the engagement partner from the City's Audit Firm, and the Business Manager for the Burlington School Department. We also reviewed numerous documents associated with the current and past audits of the City and other information provided by the CAO as requested by the Committee related to the City and its audit process.

RECOMMENDATIONS

Following are our recommendations. We acknowledge that some may require changes to the City Charter or entail organizational changes within the City's current governance or organizational structure. However, we have not explored in detail the nature or significance of these changes, as we deemed that outside the scope of our assignment. Furthermore, our recommendations are not intended to suggest a material deficiency in the execution of the City's current audit or with the performance of those involved in the audit process, but rather are intended to improve the overall audit process.

1. Establish an Independent Audit Committee The ATF believes that this is the most important recommendation and one that will help position the City to achieve improved accountability and transparency in its financial operations governance and strengthen the overall audit process. Many of the other recommendations noted below presume the establishment of an Independent Audit Committee.

Discussion:

Although the Burlington's charter allows for the Finance Committee to act as a "board of audit" and contains language concerning "adopting systems of accounting and auditing for each department of city government....," it does not contemplate the current complexity in City governance, the multitude of different City operations which range from an airport to a school department, to a marina, or the evolution of "best practices" as they relate to accounting, auditing and governance.

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There is a growing trend for municipalities to create an Independent Audit Committee to improve overall governance practices. Dealing with complex accounting concepts, financial systems, bond indentures, internal control systems, federal funding requirements and complex financial structures – much less the auditing of these areas – is not something most individuals are familiar with. Elected City councilors may not be well versed in these areas. Consequently, in contrast to the Executive Branch with professionals who are directly responsible for managing the City's financial affairs, City Counselors are placed at a distinct disadvantage. The establishment of an Independent Audit Committee to advise the City Council in these matters will improve the City's overall governance, enhance accountability to its citizens and significantly strengthen the City's overall audit process.

Formation:

We recommend the Audit Committee be structured independent of the Mayor as the City's elected Chief Executive, and his/her staff. Independence of the Committee from the Executive Branch of City Government is crucial to the Committee's ability to serve its role as an important component of the system of checks and balances related to the audit of the City's operations.

This means that the makeup of the Audit Committee should be structured so that it includes one or more members of the City Council and two or more "experts" from the local community who are knowledgeable in accounting principles and auditing standards, internal control systems, financial reporting and have an understanding of audit committee operations.

The Audit Committee should report directly to the City Council and be granted the responsibility and authority to engage the independent auditors without further review or approval from the Council or Executive Branch. The Committee should meet at least 4 times a year to review the scope of the engagement, the interim audit process, and the final audit results and management letter on internal controls and other matters.

It should have executive sessions at each meeting in which members of the public and executive branch staff are excused so that a frank and open communication can occur among the Committee, between the Committee and Auditor and between the Committee and Executive Branch of the Administration. These are "best practices" in the private sector and required in many instances by regulatory bodies. Any material issues brought up during the executive session should then be reported to the City Council, as appropriate.

For further information regarding recommended practices of the Audit Committee, reference is made to the American Institute of Certified Public Accountant's publication entitled: *The AICPA Audit Committee Toolkit: Government Organizations*.

2. Audit Scope We recommend that the Audit Committee consider the overall scope of auditing the City's operations. This may entail expansion of the scope of the annual audit, the creation of an internal audit function within the City's structure, in consultation with the Administration and City Council, or the use of "agreed upon procedures" from independent accountants to supplement the current audit effort.

Discussion

The overall audit scope of the City is annually evaluated by City management and the independent auditors in order to meet the minimum requirements under professional standards as well as Federal and other funding source requirements. The City prepares its Comprehensive

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Audit Financial Report (CAFR) that includes all of its operations as required under professional standards issued by the Governmental Accounting Standards Board.

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Currently, BED is separately audited due to its historical significance relative to the City, the uniqueness of its operations, and certain requirements related to its majority ownership in the McNeil facility. In addition to being audited by a different audit firm, it publishes a completely separate set of financial statements from those of the City.

It should be noted that the City did not historically prepare or receive separate Audit Reports for certain significant City components such as the School Department and Burlington Telecom. However, the Request For Proposal (RFP) concerning the 2010 City audit indicates that separate audit reports for the School Department and Burlington Telecom will be issued along with the usual separate audit reports done for the Airport and Wastewater Departments. These separate audit reports involve separate opinions by the Auditors on the basic financial statements, including footnotes. They do not, however, include separate Management Discussion and Analysis which is included in the CAFR from an overall City-wide perspective, or a separate management letter or any other communications from the auditor that would normally be associated with an independent audit and which may be pertinent to those individual departments.

These separate audit reports may be helpful to the Audit Committee, City Council, citizens, and the managers of these enterprises to better understand their financial operations and to evaluate relative performance. These, as well as all reports should be made public and placed on the City's website as soon as they are available. While financial information for the entities mentioned above are also included in the CAFR, it is sometimes difficult to "sort through" the entire complex and inter-twined disclosures within the CAFR. The ATF believes that these separate audit reports improve overall transparency, accountability and responsibility for major city activities.

The City has a significant number of enterprises and individual funds related to city operations, including significant Fiduciary funds, particularly the Pension Trust Funds, that are not subject to separate audits in the normal course, but folded into the City-wide single audit. As noted above, the Audit Committee may consider including these on a rotational basis within an enhanced scope of the annual audit, or by engaging an audit firm to perform a set of agreed upon procedures to funds considered higher risk as an additional safeguard.

Agreed upon procedures can be tailored to a specific fund and the key controls or financial risks associated with it. Agreed upon procedures are usually more cost-effective than a financial audit while still providing information to help determine whether the city's key enterprises are being managed effectively. By rotating these engagements, the marginal cost could be minimized. There may be savings realized in the city-wide audit engagement if controls over certain activities are strengthened.

Recently, concerns over pension funding and liabilities for state and municipalities have become quite prevalent in the press and represent a significant risk to all concerned. It should be noted that in the case of the Pension Fund, concerns may not be so much on valuation of assets or the paying of benefits, while admittedly very important, but on assessing the value of the funds' liabilities and the current actuarial assumptions and funding structure to meet the City's obligations under promised pension arrangements. In addition, there may be other funds with unique risks that should be periodically reviewed.

3. Auditor Engagement Process Revisions We recommend the Audit Committee increase the number of qualified firms submitting bids to conduct the City's audit.

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Discussion

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While the City's audit may be too large for most Vermont firms and perhaps too small to attract most national firms, it would be in the City's best interest to expand the list of audit firms willing to consider this engagement. The City should identify firms that audit some of Vermont's larger cities and towns and invite them to submit proposals. Also, the RFP should make it clear that joint ventures or subcontracting arrangements among firms are acceptable. By identifying a larger number of qualified firms within and outside Vermont, perhaps additional competition can be brought into the RFP process, thereby increasing competition and lowering costs, as well as involving different firms who may have different approaches, personnel and expertise. With a five year contract, firms should be more willing to absorb the non-billable time associated with the start up costs of a new audit engagement for a complex organization.

In addition, consideration should be given to lengthening the current RFP timeline to 180 days. The RFP for the June 30, 2010 citywide audit began with the issuance of the RFP on February 9, 2010 and a requirement that the selected firm be available to commence work on March 29, 2010, a period of less than two months. Furthermore, the length of the time from the date of the RFP issuance to the date of interview of the finalists was less than 5 weeks. This timeline makes it virtually impossible for an out-of-state firm or individual to obtain a Vermont license, generally a routine matter, given that the Vermont Board of Accountancy meets only monthly to consider such requests.

4. Education about the Audit Process and City Finances We recommend that the Administration undertake a program to better educate the City Council and the citizens of Burlington about the city's operations and finances. This should include information about what an audit is, and is not, as well as the significance of the management letter and other findings by the Auditor. We also recommend the Audit Committee, once organized, consider its role in this effort.

Discussion: The City of Burlington's Annual Financial Report is a comprehensive document of over 100 pages that includes a plethora of information concerning the City's operations and the numerous programs it provides and supports. While comprehensive, it is also very intimidating to the average individual. Unfortunately, professional accounting and auditing standards require the inclusion of detailed information that is often difficult to understand either in concept or in relative importance. The City ought to consider if pertinent supplemental information could be extracted from the Annual Financial Report into a separate document as a means of educating citizens about its programs and the overall financial status of the city.

In addition, City management ought to develop and present a comprehensive educational session for City Councilors and others covering basic concepts surrounding such items as: financial statements, fund accounting, auditing and the audit process, management letters, audit findings and other auditor communications, and roles of the various groups involved in the audit process. This should become part of a new City Councilor's orientation and posted on the City's website as information for citizens.

5. Address City Governance Issues While beyond our scope, we recommend the City consider establishing a Governance Committee or Task Force to review Burlington's governing framework to ensure that important fundamental governance structures are up to date relative to the current complex operation called "City Government."

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Discussion: An area that surfaced during our review was the apparent disconnect between the City and its School Department. Whether a creature of history, accident or design, it appears the current relationship is in many ways dysfunctional relative to financial operations, management and the audit process. It is our understanding that the School Department, while a major part of the City and not an independent district like so many others throughout Vermont, is under the operating supervision of the separately elected School Board. Yet, the current City Charter designates the City's Finance Board as being in charge of the audit. We understand that other issues sometimes arise relative to bonding matters and the role of the School Board relative to the City Council.

The important issue that is within the scope of the ATF is that it is our understanding that the School Board apparently has not been engaged sufficiently in the planning, reviewing or necessary follow-up of the results of the School Department portion of the audit. Of significant concern is the continued inclusion in the City's Management Letter of internal control weaknesses that relate to the School Department, but over which the Administration has no control.

This very obvious "gap" in accountability and responsibility is potentially a material risk that the City Council, Mayor and School Board ought to take seriously and strive to find solutions – regardless of any issues that may have hindered progress in the past. Perhaps a "memorandum of agreement" between the parties to solve the immediate issues is an interim step to more comprehensive "governance" re-structuring.

6. Address Management Letter Concerns The Audit Committee should establish protocols and expectations regarding management letter comments and other findings. This may entail working with the auditor to re-structure the management letter to segregate comments by each City Department, by the seriousness of the comment, and the number of times the comment has been raised. Appropriate follow-up procedures to assure necessary corrective actions have been taken should also be developed. As noted previously, an educational session should be conducted about what a management letter is and is not, and its relative importance to all concerned.

Discussion: A management letter is the auditor's vehicle to communicate concerns and recommendations regarding the City's accounting policies and procedures, internal controls and operating policies. It is a very important product of the audit engagement and the professional standards govern its issuance and terms used therein, which should be part of the educational session in the recommendation above. Repeat comments from year to year should not go unnoticed and the Administration's responses to the Management Letter ought to be reviewed and evaluated.

Not all management letter comments are equal. They can be material, involving significant risk to the organization if not rectified; relatively minor but if left unattended, could grow to be material; or "operational" in nature which are things noted by the auditor during the examination that may result in enhanced effectiveness or efficiency for the organization. Also, as part of Federal and State funding requirements, the management letter may also contain "Findings" that relate to a specific program. These findings may or may not be material, but if deemed so by the granting organization, could place past or future funding (i.e. grants) in jeopardy. Therefore, findings included in the management letter can carry unique risks in terms of possible funding issues.

It is our understanding that the City has recently undertaken a more formal process in tracking and reporting on management letter comments which is a significant step in the right direction.

7. **Audit Adjustment Disclosure** The Audit Committee should request a list and discuss, if appropriate, with the Auditor all audit adjustments discovered, passed or recorded, in connection with the City's year end audit.

Discussion The ability to rely on the interim financial information is an important consideration for the City Council and others using the information to make decisions. If there are material audit adjustments in connection with the annual audit, it might be indicative of other issues that need attention and increase risk that interim information might be misleading, such as system or understaffing issues, educational opportunities for staff, etc.

8. **Issuance of Reports and Management Letters** To enhance their usefulness, all audited financial statements, management letters and related reports should be available no later than six months after the City's fiscal year end, and sooner if possible.

9. **Accounting and Information Technology Systems** The Administration should prepare a three to five year plan detailing proposed improvements to the accounting and IT systems of the City and also outlining the costs and benefits of any upgrades and changes. We also recommend that the plan be updated annually.

Discussion: In order to have an efficient and cost effective audit process, good systems of internal controls, accounting, and information technology need to be in place. We understand the Administration has started the preparation of such a plan and we encourage regular communication with the Finance Board and the Council as the plan is developed.

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